

Message Text

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ACTION EA-12

INFO OCT-01 EUR-12 ISO-00 SP-02 USIA-06 AID-05 EB-08
NSC-05 SS-15 STR-05 OMB-01 CEA-01 CIAE-00 COME-00
FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03 LAB-04
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P R 230619Z DEC 77
FM AMEMBASSY TOKYO
TO SECSTATE WASHDC PRIORITY 3813
TREASURY DEPT WASHDC PRIORITY
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY LONDON
AMEMBASSY PARIS
AMEMBASSY ROME

C O N F I D E N T I A L SECTION 1 OF 2 TOKYO 19692

USEEC

USOECN ALSO FOR EMBASSY

E.O. 11652: GDS
TAGS: EFIN, ECON, JA
SUBJECT: PERSPECTIVE ON 7 PERCENT GROWTH TARGET

1. SUMMARY: EMBASSY BELIEVES GOJ DECISION TO SET A 7 PERCENT REAL GROWTH TARGET FOR JFY 1978 REFLECTS A DETERMINATION TO TACKLE JAPAN'S INTERNAL AND EXTERNAL ECONOMIC PROBLEMS AND BESPEAKS A WILLINGNESS TO MOBILIZE DOMESTIC POLICY TO THAT END. AS A FORECAST OF THE LIKELY OUTCOME FOR JFY 1978, 7 PERCENT IS PROBABLY OPTIMISTIC. WHETHER SETTING A TARGET WIDELY REGARDED AS AMBITIOUS WILL PROVE TO BE A GOOD MOVE MAY DEPEND SIGNIFICANTLY ON GOVERNMENTS' REACTIONS TO PROGRESS TOWARD ACHIEVEMENT OF THAT TARGET. END SUMMARY.

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2. THE DEC 15 GOJ DECISION TO ADOPT A 7 PERCENT GROWTH TARGET FOR JFY 1978 CAME AFTER EXTENDED DEBATE WITHIN THE GOVT, STRONG LOBBYING BY DOMESTIC INTEREST GROUPS, AND ACTIVE KIBITZING FROM ABROAD. DESPITE THE LATTER, IN HIS COMMENTS ON THE NEW TARGET, THE PRIME MINISTER HAS PLAYED IT AS A DOMESTIC DECISION, RESPONSIVE TO DOMESTIC NEEDS.

THIS REFLECTS BOTH THE PRIMIN'S SENSITIVITY TO ANY INDICATION THAT SUCH A KEY ELEMENT OF HIGH POLICY MIGHT BE THE SUBJECT OF FOREIGN NEGOTIATION AND THE REALITIES OF THE DOMESTIC ECONOMIC DEVELOPMENTS. IN PARTICULAR THE RISING YEN HAS HEIGHTENED DOMESTIC PERCEPTIONS THAT THE CURRENT ACCOUNT PROBLEM IS A REAL AND PAINFUL DOMESTIC PROBLEM.

3. UNTIL RECENT MONTHS, THE BROAD TRENDS OF GNP GROWTH SEEMED TO BE DEVELOPING ROUGHLY IN LINE WITH THE OFFICIAL PROJECTION OF 6.7 PERCENT REAL GROWTH FOR FY 1977. THE GOVT, INHIBITED BY ALREADY STRAINED FINANCES, TOOK A MORE CAUTIOUS APPROACH TO STIMULATING DOMESTIC DEMAND THAN IN RETROSPECT WOULD HAVE BEEN DESIRABLE. HOWEVER, THE PERCEPTION OF DEVELOPMENTS HAS CHANGED RADICALLY IN RECENT WEEKS. THE RELENTLESS RISE IN THE YEN, ESCALATING FOREIGN CRITICISM OF JAPAN'S CURRENT ACCOUNT SURPLUS, AND PRELIMINARY THIRD QUARTER GROWTH FIGURES OF ONLY 0.5 PERCENT MADE IT CLEAR THAT OFFICIAL MACRO-ECONOMIC STRATEGY WAS OFF THE TRACKS.

4. THE 7 PERCENT TARGET FOR FY 1978 IS A POLITICAL AS MUCH AS AN ECONOMIC OBJECTIVE. A COMMITMENT BY THE GOVT TO AN AMBITIOUS GROWTH TARGET HELPS MEET FOREIGN PRESSURES, BUT MORE FUNDAMENTALLY AND MORE IMPORTANTLY, IT IS DESIGNED TO SHAKE OFF THE PALPABLE GLOOM THAT HAS DESCENDED OVER INDUSTRIAL CIRCLES AS A RESULT OF THE HIGH YEN. IT IS CONFIDENTIAL

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HOPED THAT THE TARGET, BUTTRESSED BY VIGOROUS POLICY STIMULUS, WILL CONVINCE BUSINESSMEN THAT THE REQUIRED DOMESTIC-LED GROWTH TO OFFSET A DECLINING CURRENT ACCOUNT SURPLUS CAN BE ACHIEVED WITHOUT A LAPSE INTO SLUMP. AND THE HIGH TARGET ALSO HELPS TO OVERCOME RESISTANCE WITHIN THE GOVT TO EXPANDED RELIANCE ON FISCAL STIMULUS.

5. HAVING USED THE TARGET SETTING PROCEDURE TO ACHIEVE THESE OBJECTIVES, THE GOJ UNAVOIDABLY HAS LEFT ITS CREDIBILITY AT HOME AND ABROAD AT SOME RISK, PARTICULARLY IN LIGHT OF THE EXPECTED SHORTFALLS IN MEETING THE 6.7 PERCENT TARGET FOR FY 1977. MINISTERS ARE EXTREMELY AND UNDERSTANDABLY SENSITIVE ON THIS POINT AND HAVE BEEN AT PAINS TO DESCRIBE THE NEW TARGET AS AN AMBITIOUS GOAL THAT WILL BE DIFFICULT TO ACHIEVE AND WILL REQUIRE EXTRAORDINARY EFFORTS ON THE PART OF THE PRIVATE SECTOR AND LOCAL GOVTS AS WELL AS THE CENTRAL GOVT. THEY CLEARLY VIEW THE 7 PERCENT FIGURE AS A GOAL, NOT A COMMITMENT AND NECESSARILY A ROUGH ESTIMATE OF THE FORECAST FOR FY 1978, SINCE SO MUCH DEPENDS ON ITS SUCCESS IN BUILDING CONFIDENCE.

6. THE EPA FY 1978 ECONOMIC OUTLOOK (REPORTED TOKYO 19655) PROVIDES MOST OF THE ELEMENTS OF THE GOJ THINKING ON HOW THE 7 PERCENT GROWTH TARGET WILL BE ACHIEVED. WITH SOME TREPIDATION, EMBASSY WOULD MAKE THE FOLLOWING OBSERVATIONS ABOUT THE FORECAST.

(A) THE FY 1978 FIGURES ARE BASED ON STILL SKIMPY DATA FOR FY 1977. ONLY TWO QUARTERS OF FY 1977 NATIONAL INCOME DATA ARE YET AVAILABLE. THE SECOND QUARTER FIGURES FOR FY 1977 WERE DECIDEDLY LOW AT A TIME WHEN INFLATION WAS UNDER-RUNNING EARLIER PROJECTIONS. WE WOULD NOT BE SURPRISED TO SEE SIGNIFICANT REVISIONS OF THE HISTORICAL DATA.

(B) THE BETTER-THAN-PREDICTED PRICE DEVELOPMENTS OF 1977
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WILL HAVE EFFECTS ON BOTH THE STATISTICAL ESTIMATES THAT ARE MADE OF THE QUARTERLY NATIONAL INCOME ACCOUNTS AND ON REAL ACTIVITY OVER COMING MONTHS. IN PARTICULAR, IT REMAINS TO BE SEEN HOW THE SLOWED TREND OF INFLATION WILL AFFECT DECISIONS ON NOMINAL WAGE RATES TO BE SET NEXT SPRING.

(C) THE EAP FORECAST EXCLUDES PUBLIC SECTOR ACCOUNTS. ALTHOUGH THE BROAD OUTLINES OF THE GOVT'S FISCAL POLICY ASSUMPTIONS FOR THE NEXT 15 MONTHS ARE NOW CLEAR, THESE BUDGETARY INTENTIONS HAVE NOT YET BEEN TRANSLATED INTO NATIONAL INCOME ACCOUNT TERMS FOR THE PUBLIC, SO A CLEAR ASSESSMENT OF THIS ASPECT OF THE EPA FORECASTS IS NOT YET POSSIBLE.

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C O N F I D E N T I A L SECTION 2 OF 2 TOKYO 19692

C O R R E C T E D C O P Y (TEXT)

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(D) EPA'S FY 1977 FORECAST FOR A NOMINAL 9.9 PERCENT INCREASE IN PRIVATE INVESTMENT SEEMS OPTIMISTIC. THIS WILL PROBABLY BE TRANSLATED INTO A 6 PERCENT OR SO REAL INCREASE IN PRIVATE PLANT AND EQUIPMENT SPENDING. IT IS BASED ON STRENGTH IN NON-MANUFACTURING INVESTMENT, PARTICULARLY IN THE CAPITAL INTENSIVE ELECTRICITY-GENERATING SECTOR, OFFSETTING WEAKNESS IN THE MANUFACTURING SECTOR. WE SHARE THIS VIEW OF THE PATTERN OF INVESTMENT BUT THINK THE WEIGHTING IS LIKELY TO BALANCE OUT TO LITTLE, IF ANY, INCREASE IN REAL PRIVATE PLANT AND EQUIPMENT INVESTMENT. THE HIGH YEN HAS APPARENTLY ALREADY PROMPTED SOME FIRMS TO SCALE BACK INVESTMENT PLANS. SOME SLACKENING WILL BE OFFSET BY THE EFFECTS
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OF PUBLIC WORKS SPENDING INDUCING INVESTMENT.

(E) PRIVATE HOUSING INVESTMENT (ESTIMATED AT NOMINAL 13.6 PERCENT INCREASE) IS PREDICATED ON STRONG RESPONSE TO NEW GOVT PROGRAMS. SUCH AN INCREASE IS WELL WITHIN THE BOUNDS OF POSSIBILITIES BUT MUST BE VIEWED WITH SOME SKEPTICISM IN LIGHT OF RECENT WEAKNESS IN HOUSING ACTIVITY AND THE TEPID PUBLIC RESPONSE TO RECENT HOUSING MEASURES.

(F) CONSUMPTION IS ESTIMATED TO INCREASE 11.9 PERCENT IN NOMINAL TERMS (PERHAPS 5.9 - 5.5 IN REAL TERMS). WITH SAVINGS ALREADY VERY HIGH, WE HAVE NO DOUBT THAT GROWTH IN CONSUMPTION COULD EASILY KEEP PACE WITH GROWTH IN GNP. RECENTLY, HOWEVER, CONSUMPTION GROWTH APPEARS TO HAVE DECELERATED, AND THE CONFLICTING EFFECTS OF DECELERATING INFLATION AND SLOWED WAGE INFLATION ADD AN EXTRA ELEMENT OF UNCERTAINTY TO THE NEAR-TERM TRENDS.

(G) THE CURRENT ACCOUNT SURPLUS IS ESTIMATED AT \$6.0 BIL FOR FY 1978, A FIGURE WHICH WE ARE NOT PREDISPOSED TO

QUARREL WITH. IT IS PREDICATED ON A DELAYED EFFECT OF THE HIGH YEN ON EXPORTS AND A RECOVERY OF IMPORTS IN THE SECOND HALF OF FY 1978 AS THE STIMULUS TO DOMESTIC DEMAND TAKES EFFECT. SHOULD EVERYONE BE PLEASANTLY SURPRISED, HOWEVER, AND THE CURRENT ACCOUNT TURN AROUND MORE RAPIDLY THAN ANTICIPATED, THERE WOULD BE A HEAVIER DRAG ON THE ECONOMY.

7. THE FOREGOING REPRESENT AN INITIAL, INCOMPLETE ASSESSMENT. BUT IT IS OBVIOUS ENOUGH THAT, ON BALANCE, WE WOULD JUDGE THE 7 PERCENT OUTLOOK TO BE AN OPTIMISTIC FORECAST OF THE LIKELY OUTCOME FOR FY 1978. EMBASSY THUS TAKES THE EASY WAY OUT AND ADDS ITS VOICE TO THOSE OF MANY
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OTHER OBSERVERS WHO ARE SKEPTICAL ON THIS SCORE.

9. EMBASSY WOULD POINT OUT, HOWEVER, THAT THE PROSPECTS FOR ACHIEVING THE TARGET MAY TO A SIGNIFICANT DEGREE BE AFFECTED BY THE WAYS GOVTS MONITOR PROGRESS IN ACHIEVING THE TARGET. AS SUGGESTED EARLIER, WE VIEW THE AMBITIOUS TARGET FUNDAMENTALLY AS A CONFIDENCE BUILDING TECHNIQUE. IT IS BEING EMPLOYED AT A TIME WHEN BUSINESS CONFIDENCE IS SUBJECT OF MUCH CONCERN IN JAPAN, AS IN A NUMBER OF OTHER MAJOR INDUSTRIALIZED ECONOMIES, BECAUSE OF THE TENDENCY TO DISPLAY CAUTION IN PLANNING INVESTMENT OUTLAYS. INITIAL REACTION TO THE TARGET IS ALREADY NOT VERY FAVORABLE AND, IF GOVTS SOON BEGIN TO EXPRESS SKEPTICISM ABOUT THE ADEQUACY OF MEASURES TO ACHIEVE THE TARGET, IT CAN ONLY SERVE TO UNDERMINE BUSINESS CONFIDENCE AND POSSIBLY ALSO CONSUMER SPENDING. EMBASSY RECOGNIZES THAT THE TIME WILL COME WHEN PRESSURES MAY NEED TO BE GENERATED FOR ADDITIONAL ACTIONS TO ASSURE ADEQUATE GROWTH; OUR POINT, HOWEVER, IS THAT UNTIL THAT TIME IS REACHED, GOVTS SHOULD BE CAUTIOUS IN EXPRESSING SKEPTICISM ABOUT THE OUTLOOK. OF COURSE, THIS WILL NOT BE EASY, BECAUSE MAJOR OPPORTUNITIES TO START THE MONITORING PROCESS WILL BEGIN TO APPEAR AS EARLY AS NEXT FEBRUARY'S OECD MEETINGS.
MANSFIELD

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Message Attributes

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